

State Notes

TOPICS OF LEGISLATIVE INTEREST

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The Federal Budget: What Happened to the Surplus?

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At the close of fiscal year (FY) 1998, the Federal budget recorded a surplus of \$69 billion. This marked the first Federal budget surplus since FY 1969. The Federal budget surplus increased to \$127 billion in FY 1999 and to \$236 billion in FY 2000; the FY 2001 budget closed with a \$127 billion surplus. The debate on the Federal budget in Washington, D.C., quickly shifted from a debate centered around eliminating Federal budget deficits to a debate as to the proper action to deal with Federal budget surpluses. As quickly as the Federal budget debate in Washington shifted, the Federal budget surplus disappeared. The Federal budget closed FY 2002 with a \$158 billion deficit and it now appears as though the Federal budget deficit will reach \$274 billion in FY 2003. This article attempts to explain how the Federal budget went from a \$236 billion surplus in FY 2000 to a projected \$274 billion deficit in FY 2003. This \$510 billion swing in the condition of the Federal budget over a three-fiscal year period is unprecedented in Federal budget history.

Table 1 provides a summary of Federal revenues, expenditures, and surplus/(deficit) for the period FY 1998 through FY 2003, as projected. The FY 2003 expenditure number assumes that the United States Congress approves the President's FY 2003 supplemental appropriation request submitted on March 25, 2003. This supplemental appropriation request provides for \$74.7 billion of Federal expenditures for national defense and homeland security issues. The data for FY 1998 through FY 2002 are actual data and the estimates for FY 2003 are current estimates of the nonpartisan Congressional Budget Office.

Table 1

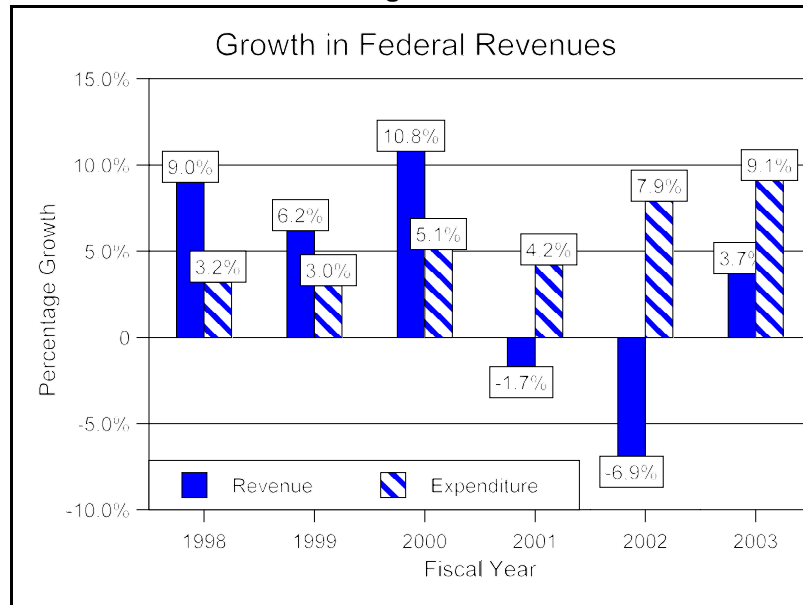
Federal Government Revenues, Expenditures and Year-End Balance (billions of dollars)			
Fiscal Year	Revenues	Expenditures	Surplus/(Deficit)
1998	\$1,722	\$1,653	\$69
1999	1,828	1,701	127
2000	2,025	1,789	236
2001	1,991	1,864	127
2002	1,853	2,011	(158)
2003	1,922	2,196 ^{a)}	(274)
a) Assumes passage of President Bush's FY 2003 supplemental appropriation request of \$74.7 billion submitted to Congress on March 25, 2003.			

Source: Congressional Budget Office, January 2003.

Figure A provides a graphic summary of the annual percentage change in Federal revenues and expenditures over the same time period. The dramatic change in the overall condition of the Federal budget is largely explained by the data in Figure A. The recent trends in Federal revenue collections and Federal expenditures are the major cause of the recent change in the overall condition of the Federal budget.



Figure 1



Federal revenues, which grew by an average annual rate of 8.1% for the period FY 1993 through FY 2000, have declined during both FY 2001 and FY 2002. This two consecutive fiscal year decline in Federal revenues has happened only rarely in Federal budget history. The last time Federal revenues declined for two consecutive fiscal years was during the FY 1946 and FY 1947 period. Other than this time period, since FY 1900, Federal revenues have declined in at least two consecutive fiscal years only in FY 1931 and FY 1932, and revenues declined for three consecutive fiscal years in FY 1921, FY 1922, and FY 1923. What also marks the recent decline in Federal revenues is the magnitude of the decrease in FY 2002. Federal revenues declined by 6.9% in FY 2002, which marks the steepest annual decline in Federal revenues since FY 1946 when Federal revenues dropped by 14.7%. The decline in Federal revenues that occurred in FY 2002 can be attributed to the recent performance of the United States economy, a significant drop in the realization of capital gains, and the impact of Federal tax policy changes.

Federal expenditures, which grew by an annual average rate of 3.3% for the period FY 1993 through FY 2000, have grown much more significantly in the FY 2001, FY 2002, and FY 2003 period. During FY 2001, Federal expenditures increased by 4.2%. During FY 2002, this rate of expenditure growth accelerated to 7.9%, and the latest projection for Federal expenditure growth in FY 2003 is 9.1%. The projected 9.1% growth in Federal expenditures during FY 2003 represents the largest annual growth in Federal expenditures since FY 1990, when Federal expenditures increased by 9.6%. The growth in Federal expenditures that has occurred over the past three fiscal years can be attributed to large increases in defense spending and substantial increases in other Federal programs such as Medicaid and payments for unemployment benefits.

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Table 2 provides more detail regarding the performance of Federal revenues for the FY 1998 through FY 2003 period. The decline in Federal revenues during the FY 2001 and FY 2002 period was fueled by significant decreases in both individual and corporate income tax collections. Individual income tax collections declined by 1.1% in FY 2001 and dropped by a steep 13.7% in FY 2002. Corporate income tax collections declined by 27.0% in FY 2001 and by 2.0% in FY 2002. Individual income tax collections fell as a result of declines in the realization of capital gains, the general state of the economy, and the impact of Federal individual income tax reduction. Corporate income tax collections fell as a result of falling corporate profits, which were affected by the general state of the economy. The performance of individual income tax collections during FY 2001 and FY 2002 marks a sharp contrast from recent years. Individual income tax collections had increased by an annual average of nearly 11.0% in the prior six fiscal years. The other large component of Federal revenues, social insurance taxes, continued to grow throughout the entire period. Social insurance taxes consist of Social Security payroll taxes and Medicare payroll taxes.

Table 2

Recent Trends in Federal Revenues (billions of dollars)					
Fiscal Year	Individual Income	Corporate Income	Social Insurance	All Other	Total
1998	\$829	\$189	\$572	\$132	\$1,722
1999	880	185	612	151	1,828
2000	1,005	207	653	160	2,025
2001	994	151	694	152	1,991
2002	858	148	701	146	1,853
2003	899	156	725	142	1,922

Source: Congressional Budget Office, January 2003

Table 3 provides more detail regarding the performance of Federal expenditures for the FY 1998 through FY 2003 period. The large increases in Federal expenditures in FY 2002 and FY 2003 are driven by several factors. First and foremost, defense expenditures increased by 14.1% in FY 2002 and are expected to increase by at least 26.1% in FY 2003. The Federal government's efforts to combat worldwide terrorism and the current war in Iraq have led to these increases in defense spending. It is possible that defense spending in FY 2003 actually will rise by more than 26.1%, as this increase is based on projections of the cost of the war in Iraq as of late March 2003. Nondefense discretionary spending increased by 12.2% in FY 2002 and by 10.4% in FY 2003. Nondefense discretionary spending funds the general operations of the Federal government and other programs such as transportation, education, economic and workforce development, and health research. Cost increases in mandatory Federal medical programs also have increased in the past two fiscal years. Federal expenditures on the Medicaid program rose by 13.8% in FY 2002 and by 6.1% in FY 2003. Federal expenditures on the Medicare program increased by 6.7% in FY 2002 and 5.9% in FY 2003. Offsetting some of these recent large increases in Federal expenditures has been a significant drop in Federal expenditures on servicing the Federal debt. Interest payments on the Federal debt have declined for the past four fiscal years, including a 17.0% decline in FY 2002 and a 8.2% decline in FY 2003.

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Table 3

Recent Trends in Federal Expenditures (billions of dollars)						
Fiscal Year	Defense	Nondefense Discretionary	Medicaid/ Medicare Social Security	Interest	All Other	Total Outlays
1998	\$270	\$282	\$688	\$241	\$172	\$1,653
1999	275	297	704	230	196	1,702
2000	295	320	739	223	212	1,789
2001	306	343	797	206	212	1,864
2002	349	385	855	171	251	2,011
2003 ^{a)}	440	425	900	157	272	2,194
a) Assumes passage of President Bush's FY 2003 supplemental appropriation request of \$74.7 billion submitted to Congress on March 25, 2003.						

Source: Congressional Budget Office, January 2003

In summary, the Federal budget has undergone a significant transition in recent years. Federal budget deficits in the period FY 1970 through FY 1997 gave way to four consecutive years of Federal budget surpluses beginning in FY 1998. The condition of the Federal budget turned around again in FY 2002 as deficits returned. How long the United States will face Federal budget deficits depends on the future course of the national economy coupled with Federal fiscal policies enacted by the United States Congress and the President. In reviewing the recent condition of the Federal budget one fact is certain: Federal budget conditions can change rapidly.